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The Empty Promise of Estate Tax Repeal

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THE EMPTY PROMISE OF ESTATE TAX REPEAL

*Grayson M.P. McCouch**

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I. INTRODUCTION

For more than eighty years, the estates of wealthy decedents have been subject to federal estate taxation. At first glance, the estate tax may appear to play a relatively minor role in the federal tax system. Compared to the personal income, corporate, or payroll taxes, the estate tax applies to a very small group of taxpayers and raises little revenue. Nevertheless, in recent years it has become the focus of heated controversy and extravagant rhetoric. Opponents have mounted a sustained campaign to abolish the tax, which they invariably refer to as the “death tax,” portraying it as wasteful, ineffective, and fundamentally unfair. The anti-tax campaign gathered momentum in the late 1990s and moved into high gear in 2001 when George W. Bush was inaugurated as president. In his first major

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domestic policy initiative, President Bush called for massive tax cuts, including estate tax repeal, which Congress duly enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (the 2001 Act).¹

The 2001 Act provides sizable income and estate tax cuts over a protracted phase-in period, culminating in 2010 with repeal of the estate tax and introduction of a modified carryover basis system for inherited property.² These changes are not permanent, however. Under a special “sunset” provision, the tax cuts are scheduled to expire automatically at the end of 2010, and prior law will spring back into force for 2011 and subsequent years.³ Thus, if Congress takes no further action, the estate tax will disappear in 2010 and then reappear one year later. This bizarre result reflects a political stalemate between two competing groups: root-and-branch abolitionists who insist on complete and permanent repeal, and defenders of the tax who are willing to consider reform but balk at outright repeal. In 2001 the abolitionists were able to declare victory of a sort, for they succeeded in putting estate tax repeal on the books, but in the intervening years they failed to make repeal permanent. It now seems increasingly likely that the estate tax will survive in some form, although the details still have to be worked out.

The outlines of a pragmatic compromise involving a larger exemption and lower rates have been apparent since 2001.⁴ Why, then, has it proved so difficult for the opposing factions to reach an agreement? The protracted controversy can be explained largely as an exercise in political brinkmanship and anti-tax ideology. The notion of estate tax repeal may have proved effective in rallying political support for the Bush administration’s ambitious tax-cutting agenda,

¹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

² The 2001 Act also calls for repeal of the generation-skipping tax in 2010 but leaves the gift tax in place. *See id.* §§ 501 (terminating estate and generation-skipping taxes after 2009), 541 (terminating death-time basis step-up for property acquired from a decedent after 2009), 542 (introducing carryover basis for property acquired from a decedent after 2009).

³ *See id.* § 901(b) (reinstating prior law for 2011 and subsequent years “as if [the 2001 Act] had never been enacted”).

⁴ *See* H.R. REP. NO. 107-37, at 194 (2001) (\$2,000,000 exemption); H.R. 5008, 107th Cong. (2002) (\$3,500,000 exemption and 50 percent top marginal rate). For more recent proposals along similar lines, *see* H.R. 4242, 110th Cong. (2007) (\$3,500,000 exemption and 47 percent top marginal rate); H.R. 4172, 110th Cong. (2007) (\$3,500,000 exemption); H.R. 3475, 110th Cong. (2007) (\$5,000,000 exemption).

but from a tax policy perspective it is deeply flawed. As a practical matter, the political stalemate can be resolved only when abolitionists acknowledge that outright repeal is neither simple nor costless.

II. RHETORIC OF REPEAL

Estate tax repeal emerged as a mainstream political issue in the 1990s. At the beginning of the decade, outright repeal was still generally viewed as unattainable, even among business owners, farmers, and other groups traditionally opposed to the tax.⁵ Nevertheless, by 1999, repeal had become a politically potent slogan and an integral part of the conservative anti-tax agenda, thanks to the efforts of activists who worked tirelessly and single-mindedly to mobilize public opinion against the estate tax.⁶ Their aim was not to inform but to persuade, and their message was simple, clear, and powerful. They denounced the estate tax as fundamentally “wrong” and “unfair,” portraying it as a penalty on hard work and saving as well as a threat to ordinary families and small businesses.⁷ Endlessly repeated and amplified in think-tank papers, op-ed pieces, and radio talk shows, the abolitionists’ message eventually became accepted as an indisputable article of faith in anti-tax circles and as conventional wisdom among large segments of the general public.⁸

⁵ The estate tax did not figure among the tax cut priorities listed in the Republican leadership’s 1994 “Contract With America.” See REPUBLICAN NATIONAL COMMITTEE, CONTRACT WITH AMERICA 16–19 (Ed Gillespie & Bob Schellhas eds., 1994) (advocating child tax credit, reduction in marriage tax penalty, tax-favored individual savings accounts, reduction in capital gains tax rate, and business tax incentives).

⁶ For an illuminating account of the campaign for estate tax repeal and the enactment of the 2001 Act, see MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH (2005); see also DAVID CAY JOHNSTON, PERFECTLY LEGAL 71–91 (2003).

⁷ In the words of one prominent political consultant, the estate tax is the “wrong tax,” comes at the “wrong time,” hurts the “wrong people” and helps the “wrong people.” “The Death Tax is simply unfair. It tells every American that no matter how hard you work or how wisely you manage your affairs, in the end the federal government is going to step in and take it away. The estate tax . . . punishes hard work and savings, it fails to raise the kind of revenues that might conceivably justify some of the damage it causes. It has been destroying businesses and ruining lives for four generations. . . .” GRAETZ & SHAPIRO, *supra* note 6, at 81–82 (quoting Frank Luntz).

⁸ For an excellent discussion of the complex interplay between opinion polls and perceptions of popular opinion, see *id.* at 118–30 (noting that opinion polls are often designed to elicit a desired response and the results are then used “to rally the

Opponents of the estate tax skillfully designed their message to shape the terms of the debate, and they succeeded in two important ways. First, they portrayed the estate tax as a heavy burden for ordinary families and offered repeal as a simple, attractive solution. Their account of the estate tax was essentially a caricature that lampooned the tax's shortcomings and exaggerated its burdens. As economic analysis, the argument was shallow and tendentious, but as political rhetoric, it worked effectively to reinforce popular misperceptions about the estate tax and fuel anti-tax sentiment.⁹ The case against the tax was freely embellished with compelling personal stories that pitted plucky entrepreneurs and their families against heartless tax collectors. Although some of the stories were semi-fictionalized, factual accuracy was not important; the purpose of the stories was to put a human face on the anti-tax message and enhance its dramatic impact.¹⁰ Indeed, the argument against the estate tax relied more on emotional persuasion than on reasoned analysis. The abolitionists were not interested in examining alternative theories or empirical evidence, nor were they concerned about the practical implications of repeal. Having set out to eliminate the estate tax, they tailored every facet of their message to point unequivocally toward repeal.

The second way in which the anti-tax message shaped the debate lay in its appeal to fairness and morality. The estate tax has long been viewed by its defenders as promoting equality of opportunity by curbing concentrations of inherited wealth. In a bold rhetorical move, the abolitionists seized the moral high ground and denounced the estate tax as fundamentally unfair. Equating wealth and success with traditional virtues of hard work, prudent saving, and self-reliance, they portrayed the estate tax as a penalty on virtue and an enemy of the "American dream." The abolitionists thus achieved the remarkable feat of articulating a populist rationale for an anti-progressive tax agenda. More importantly, they shifted the debate

faithful, get media attention, and intimidate potential opposition").

⁹ Many Americans are "unrealistically optimistic" about their own economic circumstances, both in absolute terms and relative to others, and exaggerate their prospects of becoming rich. *Id.* at 119; *see also id.* at 96 ("[P]olls routinely show that some 20 percent of the American population *believe* that they are in the top 1 percent, and another 20 percent believe that they will soon reach that echelon."). Many Americans also have wildly exaggerated ideas of the proportion of estates subject to tax. *See id.* at 125 (noting widespread belief that "most" families have to pay estate tax).

¹⁰ *See id.* at 50–66 (discussing role of personal stories).

away from contestable issues of tax policy to the abstract realm of absolute moral values. By framing the estate tax debate in terms of fairness, they infused their anti-tax message with a sense of moral rectitude and signaled that they would settle for nothing less than full repeal.

III. POLITICS OF REPEAL

By the end of the 1990s the abolitionist message had gained political traction.¹¹ Estate tax repeal figured as a prominent issue in the 2000 presidential campaign, especially after candidate George W. Bush endorsed repeal as part of his tax-cutting agenda, along with income tax rate cuts, an expanded child credit, and reduction of the marriage tax penalty.¹² With Bush's inauguration as president, the prospects of enacting estate tax repeal improved dramatically. Assimilation into the tax-cutting agenda came at a price, however, for the Bush administration exercised total control over the terms of its proposals and demanded unwavering support from its allies. To coordinate political support for its proposals, the administration assembled a formidable new coalition which enforced strict discipline and prevented business groups from pursuing their own separate tax proposals.¹³ As estate tax repeal gained political momentum, it also became hostage to the administration's much larger and more ambitious tax-cutting agenda.

The Bush administration formulated its proposals against the backdrop of a large projected budget surplus, which briefly opened a window of opportunity to pay down the federal debt, pursue

¹¹ In 1999 and again in 2000 Congress passed estate tax repeal legislation, which was vetoed both times by President Clinton. *See* Death Tax Elimination Act of 2000, H.R. 8, 106th Cong. § 101 (2000); Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. § 601 (1999).

¹² The decision to include estate tax repeal was essentially "a political decision, not an economic one." GRAETZ & SHAPIRO, *supra* note 6, at 138. Bush's political advisers recognized the broad appeal of estate tax repeal, but his economic team was primarily interested in income tax cuts. *See id.* at 134–39 (discussing Bush's tax proposals).

¹³ *See id.* at 158–65 (discussing Tax Relief Coalition). As the head of the Tax Relief Coalition commented, "There is an umbilical cord to the White House. . . . TRC is not a debating society. . . . You either support the administration's proposals and only those changes the administration agrees to, or you leave the team." *Id.* at 165 (quoting Dirk Van Dongen). Thus, for example, the administration made it clear that business tax cuts would not be included in the 2001 package and business groups would have to wait their turn. *See id.* at 161–62.

fundamental tax reform, or cut taxes.¹⁴ The Bush administration opted for massive tax cuts. Although there was bipartisan support in Congress for some form of tax relief, the size of the administration's package proved controversial and it became clear that the proposed tax cuts would have to be scaled back in order to pass the budget resolution in the Senate.¹⁵ The estate tax cuts came under especially intense pressure, for many legislators cared less about getting rid of the estate tax than about delivering broad-based income tax cuts.¹⁶ To bring the ten-year revenue cost of the 2001 Act within the \$1.35 trillion ceiling established in the budget resolution, lawmakers resorted to various gimmicks including phase-ins, phase-outs, and sunsets.¹⁷ It had long been clear that estate tax repeal would have to be phased in over time; the cost of immediate repeal would have been prohibitively high. To minimize the cost of the estate tax cuts during the ten-year budget window, the 2001 Act called for gradual cuts in the top marginal rate and periodic increases in the estate tax exemption, followed by full repeal and the introduction of carryover basis in 2010.¹⁸ In a last-minute scramble for revenue, the conference

¹⁴ In January 2001 the Congressional Budget Office projected a ten-year budget surplus of \$5.6 trillion (including an off-budget surplus of nearly \$2.5 trillion primarily attributable to Social Security). See CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2002-2011, at xiv (2001). By January 2002, the projected surplus had dwindled to \$1.6 trillion. See CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2003-2012, at xiii (2002).

¹⁵ The budget resolution invoked a reconciliation process which ensured that the 2001 Act could pass in the Senate with a simple majority of 51 votes (rather than a supermajority of 60 votes). See Karen C. Burke & Grayson M.P. McCouch, *Estate Tax Repeal and the Budget Process*, 104 TAX NOTES 1049, 1052-53 (Sept. 6, 2004); Michael W. Evans, *The Budget Process and the "Sunset" Provision of the 2001 Tax Law*, 99 TAX NOTES 405, 407 (Apr. 21, 2003); Robert Keith & Bill Heniff Jr., *The Budget Reconciliation Process: House and Senate Procedures* 1-3 (Cong. Res. Serv., Report No. RL33030, 2005).

¹⁶ This should not be surprising. Opinion polls reveal far less popular support for estate tax repeal as an alternative to broad-based income tax cuts than as a stand-alone issue. See GRAETZ & SHAPIRO, *supra* note 6, at 122-23.

¹⁷ The budget resolution capped the ten-year cost of the tax cuts at \$1.35 trillion, the sum of \$1.25 trillion — midway between the estimated ten-year cost of President Bush's original proposals (\$1.6 trillion) and the Democrats' counter-offer (\$900 billion) — plus \$100 billion for retroactive economic stimulus. See *id.* at 178-79, 186-87.

¹⁸ See Karen C. Burke & Grayson M.P. McCouch, *Estate Tax Repeal: Through the Looking Glass*, 22 VA. TAX REV. 187, 193-94 (2002). The revenue losses from the estate tax cuts were heavily weighted toward the far end of the ten-year budget window. See STAFF OF JOINT COMM. ON TAXATION, 107TH CONG., ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1836, at 3 (Joint

committee added two further gimmicks, accelerating the phase-out of the state death tax credit and preserving the gift tax as a stand-alone tax.¹⁹ The ten-year revenue cost of the estate tax cuts under the conference agreement was less than half the estimated cost under the Bush administration's proposals.²⁰

The long-term revenue cost of estate tax repeal presented a more intractable problem. Under the 2001 Act, only one year of repeal was included within the ten-year budget window, but if repeal were made permanent, the true cost would rapidly escalate for years outside the budget window. Although tax cuts could be enacted by a simple majority vote in both houses of Congress, the so-called Byrd rule made it virtually impossible to make the tax cuts permanent without a sixty-vote supermajority in the Senate.²¹ Under the sunset provision agreed to in conference, all of the tax cuts would automatically expire at the end of 2010, thereby avoiding the prospect of a Byrd rule challenge and ensuring that the tax cuts could be enacted with a simple majority in the Senate.²² In effect, the sunset provision limited the scheduled repeal of the estate tax to a single year following a

Comm. Print 2001) (showing more than half of total revenue losses in last two years of ten-year period).

¹⁹ The state death tax credit was phased out and replaced with a new deduction in 2005. The effect was to shift substantial revenue from the states back to the federal government. See GRAETZ & SHAPIRO, *supra* note 6, at 191, 209–11. The decision to retain the gift tax as a stand-alone tax in 2010, instead of letting it disappear along with the estate and generation-skipping taxes, came in response to a memo from the Chief of Staff of the Joint Committee on Taxation estimating unexpectedly large revenue losses due to income tax avoidance opportunities. See *id.* at 181–82 (noting prediction of “50 cents or more of lost income taxes for every dollar lost directly from estate and gift tax repeal”).

²⁰ See U.S. DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2002 TAX RELIEF PROPOSALS 59 (2001) (showing \$271.5 billion cost under administration's proposals); STAFF OF JOINT COMM. ON TAXATION, *supra* note 18, at 3 (showing \$133.2 billion cost under 2001 Act).

²¹ Under the Byrd rule, any reconciliation legislation that increases deficits in years beyond the period covered by the budget resolution is subject in the Senate to a point of order which can be waived only by a three-fifths vote (sixty votes if all members are present). If the 2001 Act had been introduced outside the reconciliation process, the bill would have been subject to a filibuster under the Senate's regular rules, requiring sixty votes for cloture. See Burke & McCouch, *supra* note 15, at 1052–53; Evans, *supra* note 15, at 414; Robert Keith, *The Budget Reconciliation Process: The Senate's "Byrd Rule"* 2–7 (Cong. Res. Serv., Report No. RL30862, 2005).

²² The conference agreement passed the Senate by a 58–33 vote, two votes short of the number that would have been required to override a Byrd rule challenge.

protracted phase-out period, and left the issue of permanent repeal unresolved.

The Bush administration and its allies in Congress almost certainly could have marshaled the necessary votes to enact permanent estate tax cuts in 2001, had they been willing to settle for a compromise package that provided a higher exemption and lower rates.²³ Instead, they insisted on complete estate tax repeal, no matter how long delayed, confident that once repeal was on the books they would be able to make it permanent. In hindsight this appears to have been a risky gamble, but at the time it may have seemed like a reasonable strategy. From the outset, the abolitionists viewed estate tax repeal as a nonnegotiable matter of principle, and in framing their message they appealed to abstract values of fairness, optimism, and self-reliance. It was this intransigent stance of moral commitment that energized the campaign for repeal and at the same time made it difficult to reach a pragmatic compromise.²⁴ Similarly, the simple slogan of estate tax repeal provided a rallying point for members of the administration's coalition of anti-tax groups. Many business owners and farmers in the coalition might have preferred immediate relief in the form of a higher exemption and lower rates, especially compared to the bizarrely convoluted and evanescent version of repeal that was ultimately enacted.²⁵ But there is no indication that they had any choice in the matter. Indeed, any discussion of alternatives to complete repeal might have splintered the coalition and derailed the political momentum behind the administration's tax

²³ See H.R. REP. NO. 107-37, *supra* note 4, at 194 (describing proposal by dissenting committee members to retain estate tax with immediate increase in exemption to \$2 million); H.R. 5008, 107th Cong. (2002) (proposing retention of estate tax with \$3.5 million exemption and 50 percent top marginal rate); see also William G. Gale & Peter R. Orszag, *Should the President's Tax Cuts Be Made Permanent?*, 102 TAX NOTES 1277, 1279 (Mar. 8, 2004) (noting that, within the reconciliation process, the Bush administration could have sought "a smaller tax cut within the ten-year budget window in exchange for making the tax cut permanent" but refused to do so).

²⁴ See GRAETZ & SHAPIRO, *supra* note 6, at 261 ("The same moral commitments that held the group together made it difficult to compromise.").

²⁵ For a significant number of taxpayers at the lower end of the spectrum of taxable estates, an immediate increase in the exemption, together with an unlimited deathtime basis step-up, would have been objectively preferable to the remote possibility of repeal coupled with carryover basis. For a few extremely wealthy families, however, neither an increased exemption nor lower rates would provide significant benefits compared to complete repeal. For them, maintaining a unified coalition and pressing for complete repeal may have been a rational strategy. See *id.* at 191, 214-17, 258-59.

cuts.²⁶ In short, for committed abolitionists, anything short of complete repeal would have spelled moral weakness and political defeat.

If the abolitionists expected to follow up on the 2001 Act with a decisive vote for permanent estate tax repeal, the gamble has not paid off. Despite repeated attempts since 2001 to make repeal permanent, they have failed to muster the necessary sixty votes in the Senate.²⁷ At the same time, no working majority has coalesced around any realistic reform proposal. As a result, the 2001 Act has ushered in a period of instability and uncertainty concerning the future of the estate tax. This situation offers lawmakers a golden opportunity to solicit contributions from lobbyists and wealthy constituents seeking to make estate tax repeal permanent.²⁸ Indeed, Professors Edward McCaffery and Linda Cohen see this “shakedown” dynamic as the key to the political standoff over estate tax repeal.²⁹ They argue that opponents of the tax could have mobilized at least sixty votes for permanent repeal in the Senate in 2001³⁰ but deliberately chose not to do so in

²⁶ See *id.* at 191 (noting that “decision-making in the coalition had become a top down affair”), 217 (noting that in the run-up to enactment of the 2001 Act “the only way to sustain the momentum for the tax bill was to put on blinders, ask few questions, and push for repeal”).

²⁷ See, e.g., Death Tax Repeal Permanency Act of 2007, H.R. 2380, 110th Cong. (2007); Death Tax Repeal Act of 2007, H.R. 1586, 110th Cong. (2007); Death Tax Repeal Permanency Act of 2005, S. 420, 109th Cong. (2005); Death Tax Repeal Permanency Act of 2005, H.R. 8, 109th Cong. (2005); Permanent Death Tax Repeal Act of 2003, S. 169, 108th Cong. (2003); Death Tax Fairness Act of 2003, S.13, 108th Cong. (2003); Permanent Death Tax Repeal Act of 2003, H.R. 139, 108th Cong. (2003); Death Tax Permanency Act of 2003, H.R. 57, 108th Cong. (2003); Death Tax Repeal Permanency Act of 2003, H.R. 8, 108th Cong. (2003); Permanent Death Tax Repeal Act of 2002, H.R. 2143, 107th Cong. (2002); Tax Relief Guarantee Act of 2002, H.R. 586, 107th Cong. (2002).

²⁸ See Burke & McCouch, *supra* note 15, at 1056 (“[B]y deferring repeal until the end of an extended phase-in period, the repealers ensure that they can take advantage of continuing uncertainty and instability to extract contributions from wealthy political donors.”); cf. Johnston, *supra* note 6, at 78 (noting that delayed repeal affords “years of opportunities to raise money from donors who could see the abyss coming and would be eager to speed up the effective date of repeal”).

²⁹ See Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159 (2006).

³⁰ See *id.* at 1211 (“[A] simple vote-counting . . . indicates that sixty votes were well within reach.”). It is not at all clear, however, that sixty votes could have been mobilized for repeal. Based on a tally of Senate votes during the period 2000-2003, McCaffery and Cohen note that there were “more than sixty Senators who had voted for repeal of the estate tax at one time or another” and also “more than forty Senators who had voted against repeal of the estate tax at one time or another.” *Id.* at

order to prolong the debate and extract a continuing stream of campaign contributions.³¹

At one level, the “ex ante rent-extraction model” elaborated by McCaffery and Cohen represents a plausible extension of standard public choice theory.³² Indeed, it would be surprising if legislators did *not* take advantage of their position to extract favors of one sort or another from lobbyists. But it is hard to accept their model as the only (or even the most) plausible explanation for the protracted battle over estate tax repeal.³³ In particular, McCaffery and Cohen downplay the role of budget rules as part of a complex, often opaque legislative process. Budget rules may be crude and malleable but they are not meaningless.³⁴ The revenue cost of the tax cuts during the ten-year

1210. From this they infer that “at any point in time, the Senate in the 107th Congress could have gotten sixty votes for estate tax repeal — or not.” *Id.*

³¹ See *id.* at 1165 n.17 (“[T]he Senate, in particular, deliberately strung along the issue of estate tax repeal, signaling that it had the power to kill the tax without really doing so, resisting principled compromises along the way, and staging multiple votes on the issue before resolving it in a way that could have been done ab initio — all in order to keep alive an issue of value in generating campaign contributions.”).

³² For a discussion of the economic theory of regulation and its application to tax legislation, see Daniel Shavero, *Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s*, 139 U. PA. L. REV. 1 (1990).

³³ See McCaffery & Cohen, *supra* note 29, at 1207–12 (arguing that “there are no compelling answers . . . outside the ex ante rent-extraction model” to explain Congress’s failure to enact permanent estate tax repeal in 2001). Indeed, interest-group theory predicts that if opponents of the estate tax were able to muster sixty votes in the Senate for permanent repeal they would have “powerful incentives” to do so in order to maximize the value of the legislation. See William M. Landes & Richard A. Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J. L. & ECON. 875, 882, 888–89 (1975) (noting that legislation is much more valuable if all its benefits flow without future legislative action, and that “the legislature has powerful incentives to devise methods of increasing the permanency of legislation”). An equally plausible explanation is that opponents of the estate tax realized they could *not* muster the requisite sixty votes in the Senate and accordingly made the best of the situation by continuing to press for permanent repeal while extracting annual contributions from lobbyists and interest groups.

³⁴ The gimmicks in the 2001 Act confirm that lawmakers are adept at exploiting budget rules for their own ends. See Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 677 (1995) (noting that “opportunistic and creative legislators” and staff work within and around budget rules to achieve desired outcomes). Moreover, McCaffery and Cohen note that budget rules are “*endogenous*,” that is, almost exclusively of legislators’ own making, and subject to their change.” McCaffery & Cohen, *supra* note 29, at 1203 (emphasis in original). It does not follow, however, that opponents of the estate tax had the opportunity to make repeal permanent but chose not to do so. Cf. *id.* at 1204 (arguing that lawmakers could have

budget window was constrained directly by the amount set forth in the budget resolution and indirectly by the Senate “paygo” rules in effect in 2001.³⁵ The extended phase-in of estate tax cuts flowed directly from the decision to squeeze \$1.64 trillion of tax cuts into a \$1.35 trillion container, coupled with the relatively low priority of estate tax repeal compared to broad-based income tax cuts.³⁶ More importantly, the Byrd rule effectively prevented the tax cuts from being made permanent; any extension beyond the ten-year budget window would have required sixty votes in the Senate.³⁷ The Byrd rule was designed to make it difficult to use the fast-track reconciliation process to enact legislation that would increase long-term budget deficits,³⁸ and it

altered the budget rules but “chose instead to hide behind the rules, prolonging the game”). For a discussion of supermajority voting requirements in an analogous context, see SARAH A. BINDER & STEVEN S. SMITH, *POLITICS OR PRINCIPLE? FILIBUSTERING IN THE UNITED STATES SENATE* 158 (1997) (“The Senate’s [filibuster] rule *does* affect policy outcomes, frequently at the margins, and sometimes at the core.”) (emphasis in original); *id.* at 203 (“The filibuster . . . has political consequences for legislative outcomes and strategies.”).

³⁵ See *supra* note 17. The Senate’s paygo rule, as it existed in 2001, allowed on-budget surpluses to be used to offset tax reductions or spending increases within the ten-year budget window. Because the estimated surpluses were sufficient to cover the estimated costs of the tax cuts, the 2001 Act did not violate the Senate’s paygo rule. A violation would have been subject to a point of order which could have been waived only by a three-fifths supermajority. See H.R. REP. NO. 107-60, at 91–93 (2001); Robert Keith & Bill Heniff Jr., *PAYGO Rules for Budget Enforcement in the House and Senate* 1–5 (Cong. Res. Serv., Report No. RL32835, 2005). The tax cuts were also subject to a separate statutory paygo rule which was enforceable, at least in theory, by sequestration; however, the remedy of sequestration could be avoided by various techniques including directed scorekeeping. See Burke & McCouch, *supra* note 15, at 1050; Keith & Heniff, *supra*, at 2–3; Robert Keith, *Techniques for Preventing a Budget Sequester* 7–14 (Cong. Res. Serv., Report No. RL31155, 2002).

³⁶ The drop in revenue costs for the estate tax cuts was proportionately greater than for any of the major income tax cuts. See U.S. DEP’T OF THE TREASURY, *supra* note 20, at 59 (showing cost of tax cuts in administration’s proposals); STAFF OF JOINT COMM. ON TAXATION, *supra* note 18, at 1–3 (showing cost of tax cuts in 2001 Act).

³⁷ Unlike the Senate paygo rule, which has been renegotiated and amended on a fairly regular basis, the Byrd rule has remained in place without significant changes since 1990. See Keith, *supra* note 21, at 2–4. At several points McCaffery and Cohen refer to the Byrd rule as having expired in 2002. See McCaffery & Cohen, *supra* note 29, at 1207, 1215–16 & n.186. They appear to conflate the Byrd rule with the Senate paygo rule which did in fact expire on September 30, 2002 and was restored and extended by unanimous consent on October 16, 2002. See Keith & Heniff, *supra* note 35, at 4.

³⁸ See Burke & McCouch, *supra* note 15, at 1052–53; Evans, *supra* note 15, at 408; Keith, *supra* note 21, at 2; Donald B. Tobin, *Less is More: A Move Toward Sanity in the Budget Process*, 16 ST. LOUIS U. PUB. L. REV. 115, 132 (1996) (“The general

provided significant political leverage to opponents of the 2001 tax cuts. The gimmicks in the 2001 Act demonstrate the inherent shortcomings of budget rules, particularly in light of the disintegration of political consensus on the goal of deficit control.³⁹

At a more basic level, the analysis offered by McCaffery and Cohen seems unduly narrow. In seeking to explain the dynamics of estate tax repeal exclusively in terms of rent extraction, they miss other relevant dimensions of the process: potentially conflicting interests of individual politicians, the influence of political parties, tradeoffs between alternative tax and spending priorities, concerns about revenue costs and budget deficits, institutional tensions within and between the legislative and executive branches, and the important role of anti-tax ideology. The 2001 Act and its aftermath can plausibly be explained not primarily as a deliberate strategy by individual politicians to extract campaign contributions but rather as a legislative stalemate between supporters and opponents of the Bush administration's tax-cutting agenda. Members of both factions may have been motivated in varying degrees by party loyalty, ideology, political ambition, and self-interest. To the extent they considered competing policy goals, the administration's supporters presumably placed more emphasis on economic stimulus and capital formation while opponents were more concerned with distributional equity and long-term revenue costs. While abolitionists naturally aligned

view in the Senate was that deficit reduction was so important that it warranted fast-track consideration. However, Senators wanted to make sure that this privileged procedure was applied only to measures which would decrease the deficit."). As a result of the Byrd rule, estate tax repeal can be made permanent only with sixty votes in the Senate. However, only fifty-one votes in the Senate would be required to extend repeal on a year-to-year basis. See Graetz & Shapiro, *supra* note 6, at 191; Rudolph G. Penner & C. Eugene Steuerle, *Budget Rules*, 57 NAT'L TAX J. 547, 556 (2004) (noting that the long-run budget effect is similar to a permanent tax cut but introduces "considerable uncertainty" into the tax system). Although a series of annual extensions would circumvent the Byrd rule, it would also force lawmakers to weigh estate tax repeal against other (possibly more pressing) expiring tax cuts. See *id.* at 552 (noting that reestablishing paygo rules might have "perverse effect" of giving proponents of tax cuts for the rich leverage to demand extension of those cuts in conjunction with extension of middle-class tax cuts).

³⁹ During most of the 1990s the budget rules worked effectively to enforce a political consensus on the importance of deficit reduction. However, with the unexpected emergence of surpluses beginning in 1998, the underlying consensus disintegrated and budget discipline eroded. From this perspective, the gimmicks in the 2001 Act and subsequent tax cuts may foreshadow a much larger fiscal crisis. See Penner & Steuerle, *supra* note 38, at 547-53; *id.* at 556 ("It is extremely difficult to design rules that prevent the Congress from imposing costs on future generations.").

themselves with the anti-tax faction, they apparently lacked the political clout to put estate tax repeal at the top of the administration's agenda. In calculating risks and opportunities, leaders of the anti-tax faction may have discounted the importance of the sunset provision in the 2001 Act, believing that they would eventually succeed in making all of the tax cuts permanent. In the years since 2001, however, as the cost of extending the tax cuts has become clearer, the prospects for permanent estate tax repeal have receded.⁴⁰ The abolitionists do not have time on their side.

IV. BETWEEN REPEAL AND REFORM

The legislative stalemate reflected in the 2001 Act has led to increased complexity, instability, and uncertainty in the tax law. In the near term, while the estate tax remains in place, the fallout has already manifested itself in several ways: constantly shifting rates and exemptions; inconsistent gift and estate tax exemptions that create perverse disincentives for lifetime gifts; disintegration of the longstanding system of pick-up taxes at the state level due to repeal of the state death tax credit; and, of course, persistent uncertainty about the likelihood of estate tax repeal in 2010 and subsequent years. The 2001 Act has thus made planning and compliance considerably more costly and burdensome — an ironic result, in view of abolitionists' repeated complaints about the costs and burdens imposed on taxpayers under prior law. Unsurprisingly, however, the abolitionists have seized on the complexity and uncertainty of current law as one more reason to make repeal permanent.⁴¹

⁴⁰ The cost of permanent repeal rises dramatically with each passing year under a ten-year horizon that includes years after 2010, because the total cost reflects the substitution of an additional year of foregone estate tax revenue at the end of the moving ten-year horizon for one year of undiminished revenue at the beginning of the horizon. See Burke & McCouch, *supra* note 15, at 1051.

⁴¹ Supporters of the Bush administration's tax cuts argue that "it was never anticipated that the sunset [provisions] actually would be allowed to take effect" and that "eliminating them promptly would promote stability and rationality in the tax law." STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2009 BUDGET PROPOSAL 5 (Joint Comm. Print 2008); see also OFFICE OF MGMT. AND BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2009: ANALYTICAL PERSPECTIVES 222 (2008) (arguing that tax cuts "were not intended to be temporary"). This argument ignores the fact that the reason for including the sunset provisions was to circumvent the Byrd rule and allow the 2001 Act to pass with less than sixty votes in the Senate. See STAFF OF JOINT COMM. ON TAXATION, *supra*, at 2 (noting that sunset provision in 2001 Act was included "in order to comply with reconciliation procedures").

Estate tax repeal, if it actually takes effect as scheduled in 2010, and especially if it becomes permanent as urged by President Bush,⁴² has serious implications for the income tax treatment of property passing from a decedent. Under current law, the estate tax may be viewed as compensating — admittedly in a very rough way — for the tax-free basis step-up for appreciated property acquired from a decedent.⁴³ Abolishing the estate tax while continuing to allow an unlimited deathtime basis step-up would produce large revenue losses, reinforce the tendency of most individuals to retain appreciated assets until death, and open a “gaping loophole” in the income tax.⁴⁴ Thus, as a practical matter, estate tax repeal would almost certainly have to be accompanied by a change in the deathtime basis step-up. Although this point is plain to most policy analysts, it is routinely ignored by anti-tax advocates, who prefer to focus narrowly on the burdens of the estate tax and the anticipated benefits of repeal.

There are two obvious alternatives to the deathtime basis step-up: a deathtime gains tax or carryover basis.⁴⁵ A deathtime gains tax may

⁴² See OFFICE OF MGMT. AND BUDGET, *supra* note 41, at 253, 265 tbl.17-3. President Bush’s budget proposals seek to avoid scoring the revenue loss from permanent repeal by changing the budget baseline to “[a]ssume extension of all expiring tax provisions in the [2001 Act].” *Id.* at 222. See Burke & McCouch, *supra* note 15, at 1052 (describing the use of sunset provision to avoid the appearance of long-term deficits, followed by change in baseline to avoid impact of sunset provision, as “bait-and-switch” tactic).

⁴³ See I.R.C. § 1014(a) (providing basis generally equal to fair market value of property acquired from decedent). As a proxy for a deathtime gains tax, the estate tax is both overinclusive (because it reaches fair market value, regardless of unrealized appreciation, and often applies at higher marginal rates) and underinclusive (because it fails to reach substantial amounts of property due to a large exemption and unlimited marital deduction). By some estimates up to one-half of all capital gains permanently escape income taxation due to the deathtime basis step-up. See THE TAXATION OF INCOME FROM CAPITAL 221 (Mervyn A. King & Don Fullerton eds., 1984) (noting that “about half of gains are never realized because of the increase of basis at death”); LEONARD E. BURMAN, THE LABYRINTH OF CAPITAL GAINS TAX POLICY 51 (1999).

⁴⁴ William G. Gale & Joel Slemrod, *Overview*, in RETHINKING ESTATE AND GIFT TAXATION 1, 55 (William G. Gale et al. eds., 2001); see STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2007-2011, at 28 (Joint Comm. Print 2007) (estimating \$279.9 billion tax expenditure attributable to deathtime basis step-up for fiscal years 2007-2011).

⁴⁵ See Karen C. Burke & Grayson M.P. McCouch, *Death Without Taxes?*, 20 VA. TAX REV. 499, 554 (2001) (discussing carryover basis and concluding that in the absence of an estate tax a deathtime gains tax “may be preferable [to carryover basis] in terms of distributional impact and revenue-raising capacity as well as effectiveness in curbing deferral and ameliorating lock-in”); Lawrence Zelenak, *Taxing Gains at*

be preferable to carryover basis as a matter of policy, but it has consistently failed to gain political traction, perhaps because if exemptions were set low enough to raise substantial revenue much of the burden of the tax would be shifted to middle-income taxpayers who are currently not subject to the estate tax.⁴⁶ Instead, Congress chose in 2001 to couple estate tax repeal with a modified form of carryover basis for property passing from a decedent. The central problems with carryover basis stem from its feeble revenue-raising capacity and its regressive distributional effects.⁴⁷ Carryover basis inherently allows taxpayers who inherit appreciated property to defer paying tax on the unrealized gain until they sell the property. In this context, deferral is equivalent to a reduction in the rate of tax on capital gains; the longer the deferral period, the lower the effective tax rate.⁴⁸ The benefits of deferral are greatest at the top of the wealth distribution, because the ratio of unrealized gain to asset value tends to rise with net worth.⁴⁹ In any event, the new carryover basis

Death, 46 VAND. L. REV. 361, 441 (1993) (concluding that “it is possible to design a death gains tax that is workable, fair, and raises substantial revenue” and that “taxing gains at death is a more attractive option than carryover basis”).

⁴⁶ See Burke & McCouch, *supra* note 45, at 515–16. By one estimate, a generic deathtime gains tax would raise total revenue of \$86.4 billion during the period 2002–2011 and would apply to around ten percent of decedents. See CONG. BUDGET OFFICE, BUDGET OPTIONS 421 (2001). A different study concluded that a deathtime gains tax with modest exemptions would produce a lower tax liability than the existing estate tax for 95 percent of decedents with a net worth of more than \$1 million, while the overall burden would be roughly similar to that of the estate tax for decedents with a net worth of \$1 million or less. See James M. Poterba & Scott Weisbenner, *The Distributional Burden of Taxing Estates and Unrealized Capital Gains at Death*, in RETHINKING ESTATE AND GIFT TAXATION 422, 447–48 (William G. Gale et al. eds., 2001).

⁴⁷ See Burke & McCouch, *supra* note 45, at 517–18. In 2001 the Congressional Budget Office estimated that a generic carryover basis system would raise total revenue of \$52.5 billion during the period 2002–2011, slightly more than half the yield of a deathtime gains tax. See CONG. BUDGET OFFICE, *supra* note 46, at 422 (assuming basis equal to 50 percent of deathtime value). Revenue estimates for any carryover basis system are sensitive to the time horizon for realization of gains, which in turn is extremely difficult to predict.

⁴⁸ See CONG. BUDGET OFFICE, PERSPECTIVES ON THE OWNERSHIP OF CAPITAL ASSETS AND THE REALIZATION OF CAPITAL GAINS 10–11 (1997) (noting that effective tax rate, assuming 7 percent annual appreciation, would be “about one-half the statutory rate of 28 percent if the asset was held for 30 years”).

⁴⁹ According to one study, unrealized capital gains represent 36 percent of the total expected value of all estates and 56 percent of the total expected value of estates of \$10 million or more. See Poterba & Weisbenner, *supra* note 46, at 439, 440 tbl.10-8. The composition of estate assets and sources of unrealized appreciation vary

provisions will apply only to a small number of very large estates; the 2001 Act provides generous exemptions which ensure that the vast bulk of appreciated property passing at death will continue to receive a tax-free basis step-up.⁵⁰ Ironically, it is precisely taxpayers at the top of the wealth distribution who may be able to defer realizing gains indefinitely and reduce the effective tax rate to a negligible level. For families that pass dynastic wealth intact from generation to generation, carryover basis poses no serious threat.

The carryover basis system in the 2001 Act also raises concerns about compliance and administration. Even in the absence of the estate tax, executors will be required to collect and report detailed information including adjusted basis and fair market value for property owned at death in order to make a valid allocation of any allowable basis increase.⁵¹ In addition, the statute gives executors broad discretion to allocate the basis increase among estate assets but fails to specify a default method of allocation. Executors may find their fiduciary responsibilities under the new carryover basis system to be at least as costly and burdensome as under the estate tax.⁵² Moreover, because the statute provides no formal procedure for reviewing the basis information reported by executors, there is no assurance that beneficiaries can rely on such information in reporting gain or loss on an eventual sale of property acquired from a decedent. The lack of a mechanism for making a final and binding determination

significantly within and across different wealth and income categories. *See id.* at 439, 442.

⁵⁰ The exemptions allow a basis increase for up to \$1,300,000 of unrealized appreciation in any property owned at death, as well as up to \$3,000,000 of unrealized appreciation in property passing in qualifying form to the decedent's surviving spouse. The exemptions do not apply, however, to qualified pension plans, individual retirement accounts, or other items of income in respect of a decedent. *See* I.R.C. § 1022(b), (c), (f); Burke & McCouch, *supra* note 18, at 202–12. The exemptions go far beyond what would be needed to provide targeted relief for smaller estates. For example, if a married decedent leaves an estate of \$10 million, including \$5,600,000 of unrealized appreciation, to a surviving spouse, and the spouse subsequently leaves the same amount to the couple's children, the spouses' combined exemptions will be sufficient to provide a full basis step-up. *See id.* at 204–06.

⁵¹ *See* I.R.C. § 6018(c). Although the statute requires information reporting only for estates worth more than \$1,300,000 (as well as certain gifts received by the decedent within three years before death), as a practical matter an executor must file an information return in order to allocate any allowable basis increase regardless of the size of the estate. *See* Burke & McCouch, *supra* note 18, at 216–20.

⁵² *See id.* at 212–23.

of the basis of inherited property raises serious concerns about the administrability of the carryover basis system.⁵³

The decision in the 2001 Act to retain the gift tax as a stand-alone tax in 2010 with a top marginal rate of 35 percent makes little sense in terms of tax policy.⁵⁴ As a measure to deter income shifting, a stand-alone gift tax seems cumbersome and ineffective. It perpetuates much of the complexity of current law with weakened enforcement mechanisms, and creates a perverse incentive for individuals to hold appreciated property until death in order to take advantage of the exemptions from carryover basis and obtain a limited basis step-up. In the absence of the estate tax, it is difficult to see how a stand-alone gift tax — or, for that matter, carryover basis — can last very long. Indeed, both measures may be seen as subterfuges designed to mask the costs of abolishing the estate tax.

Given the political deadlock between abolitionists and defenders of the estate tax, it is tempting to consider alternative approaches to taxing inherited wealth. The anti-tax message draws much of its rhetorical force from images of severe hardships imposed by the estate tax on virtuous, hard-working entrepreneurs; understandably, abolitionists do not dwell on countervailing images of large inherited fortunes squandered by undeserving beneficiaries. Arguably, the anti-tax message would lose some of its appeal if the debate focused on the implications of inherited wealth from the perspective of beneficiaries rather than transferors.⁵⁵ Moreover, such a shift might come about more readily if the transferor-centered estate tax were reconfigured as a beneficiary-centered tax on inherited wealth.

One leading proposal along these lines is an accessions tax which would be imposed at progressive rates on cumulative gifts and bequests received by each individual beneficiary during his or her lifetime.⁵⁶ The main advantages of the accessions tax are that it

⁵³ See *id.* at 216–20.

⁵⁴ See *id.* at 223–28.

⁵⁵ See GRAETZ & SHAPIRO, *supra* note 6, at 233–35; see also W.D. Andrews, *What's Fair About Death Taxes?*, 26 NAT'L TAX J. 465, 465–66 (1973) (suggesting that estate tax may be viewed as “a way of getting at family wealth in excess of what goes to meet each generation’s normal requirements” and that property left at death normally represents “a windfall to recipients”).

⁵⁶ See William D. Andrews, *The Accessions Tax Proposal*, 22 TAX L. REV. 589 (1967); Edward C. Halbach, Jr., *An Accessions Tax*, 23 REAL PROP., PROB. & TR. J. 211 (1988); see also John K. McNulty, *Fundamental Alternatives to Present Transfer Tax Systems*, in DEATH, TAXES AND FAMILY PROPERTY 85 (Edward C. Halbach, Jr. ed., 1977).

automatically aligns the burden of the tax with the benefit of the transfer and unifies the tax treatment of gifts and bequests. As a result, the accessions tax may be perceived as fairer than the estate tax in the sense that beneficiaries who receive equal amounts of gifts and bequests are taxed equally, without regard to the number of transferors, the size of any transferor's estate, or amounts transferred to others. In addition, by taxing accessions at the time of receipt, the tax avoids some difficult valuation problems concerning transfers in trust.⁵⁷ Nevertheless, although the accessions tax proposal has sparked considerable interest in academic circles, it has never attracted political support as a legislative proposal.

Alternatively, the taxation of inherited wealth could be integrated with the income tax by including gifts and bequests in the beneficiary's gross income.⁵⁸ The attraction of the income tax approach stems from its apparent simplicity and its implicit acknowledgment that gifts and bequests reflect ability to pay to the same extent as realized accessions to wealth from any other source.⁵⁹ On closer examination, however, this approach may not be so simple after all. Conceptually, it seems clear that a beneficiary who includes a gift or bequest of appreciated

⁵⁷ To prevent indefinite deferral of tax through the use of long-term trusts, it may be appropriate to collect a withholding tax at the creation of a trust, which could then be credited against the tax ultimately imposed on distributions to individual beneficiaries. See Andrews, *supra* note 56, at 605–13. A separate and more intractable problem arises from the widespread use of family limited partnerships and similar entities to obtain valuation discounts for lack of marketability and lack of control. See Karen C. Burke & Grayson M.P. McCouch, *Family Limited Partnerships: Discounts, Options, and Disappearing Value*, 6 FLA. TAX REV. 649 (2004).

⁵⁸ See John K. McNulty, *A Transfer Tax Alternative: Inclusion Under the Income Tax*, 4 TAX NOTES 24 (1976); Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978); see also McNulty, *supra* note 56.

⁵⁹ See McNulty, *supra* note 56, at 95–97. This approach could be implemented by repealing the longstanding income tax exclusion for gifts and bequests. For a variation on the income tax approach, see LILY L. BATCHELDER, TAXING PRIVILEGE MORE EFFECTIVELY: REPLACING THE ESTATE TAX WITH AN INHERITANCE TAX (Brookings Inst., Hamilton Project, 2007). Batchelder's proposal would tax gifts and bequests as income to the recipient at a special rate equal to the recipient's regular marginal rate plus 15 percent, subject to a cumulative lifetime exemption of \$2,300,000 (indexed for inflation) as well as smaller annual exclusions. To avoid hardship in certain cases involving illiquid assets, the tax could be deferred (with interest) until the assets were sold. Trusts with multiple taxable beneficiaries would be subject to a special withholding tax that would eventually be credited (with interest) against the tax owed by the beneficiary upon distribution. The proposal would also replace the deathtime basis step-up of current law with carryover basis. See *id.* at 16–28.

property in income should take the property with a stepped-up basis.⁶⁰ Furthermore, in the absence of an estate tax, it would be difficult to justify failing to tax the transferor on any unrealized appreciation at the time of the transfer.⁶¹ The net result — taxing the transferor on unrealized appreciation and simultaneously taxing the beneficiary on the full value of the transferred property — would almost certainly provoke charges of unfair “double taxation,” while the obvious methods of relief — substituting carryover basis for the transferor-level tax or allowing deferral of the beneficiary-level tax — would erode the effective rate of tax and impair the administrability of the income tax approach.⁶² In addition, an income tax approach that fails to impose some type of generation-skipping tax or differential rate structure would encourage very wealthy families to establish long-term dynasty trusts.⁶³

⁶⁰ This would require a change in the treatment of property acquired by gift under current law. See I.R.C. § 1015. Batchelder’s proposal would move in the opposite direction and require the beneficiary to take a carryover basis in property acquired by gift or bequest. See Batchelder, *supra* note 59, at 20 (rejecting deemed realization because it “might undercut political support for taxing inherited income”); *id.* at 45 (asserting, without explanation, that “experience suggests that carryover basis for bequests would be workable”). In this context, carryover basis appears conceptually awkward and also raises significant practical problems of implementation. See *id.* at 21 (suggesting basis step-up for appreciated assets worth less than \$10,000 and not held for production of income).

⁶¹ See Burke & McCouch, *supra* note 45, at 551–52 (“[I]ncluding gifts and bequests in the recipient’s income tax base implies not only that the recipient would receive the transferred property with a fair-market-value basis (reflecting the amount included in income) but also that the transferor would realize any built-in gain at the time of the transfer.”).

⁶² Batchelder’s proposal would allow a beneficiary to defer the tax on inherited illiquid assets (e.g., a closely held business or farm) to the extent the tax could not be paid with other inherited liquid assets. See Batchelder, *supra* note 59, at 21–23. Moreover, “if the heir held on to an illiquid asset for life and ultimately bequeathed it to someone else, the associated tax would carry over to the new heir.” *Id.* at 23. In this situation, deferral would amount to a reduction in the effective rate of tax, notwithstanding the accruing interest charge, because all subsequent transfers from one beneficiary to the next during the deferral period would escape tax entirely. The only tax that would ever be paid (when the asset was eventually sold) would be the tax on the transfer to the initial beneficiary (plus interest).

⁶³ Cf. Andrews, *supra* note 55, at 466–67 (“Transfers are the convenient occasion for imposing tax, but the underlying object is transmission of wealth, and a transfer [from] a grandparent to a grandchild involves twice as much transmission as does a transfer from parent to child. . . . Wealth transferred from grandparent to grandchild is surplus in relation to two generations, not just one.”).

Perhaps, after all, incremental adjustments to the existing estate tax represent the most realistic prospect for reform. In the current political climate, it is difficult to imagine opponents of the estate tax embracing any alternative system of taxing inherited wealth, even (or perhaps especially) one that might be widely perceived as fairer and more effective than the estate tax.⁶⁴ Looking ahead, the central task will be to mitigate the damage done in 2001 and establish a reunified estate and gift tax system with an indexed exemption of reasonable size and a moderately graduated rate structure.⁶⁵

V. CONCLUSION

The terms of the debate over the estate tax have been framed largely by abolitionists who have relentlessly propounded a powerful anti-tax message that portrays the estate tax as unambiguously harmful and threatening to ordinary families and small businesses. The attack on the estate tax is inextricably linked to a larger agenda of eliminating taxes on capital and capital income and dismantling the progressive elements of the federal tax system.⁶⁶ The slogan of estate tax repeal, while remarkably effective in mobilizing anti-tax sentiment, makes no sense as a matter of tax policy because it

⁶⁴ Estate tax repeal is not inherently inconsistent with the goal of making the tax system simpler and fairer. See, e.g., Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 345, 352 (1994) (advocating “progressive consumption-without-estate tax” with separate, higher rates on consumption from inherited wealth); Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807, 812 (2005) (advocating “progressive postpaid consumption tax” as “the fairest and least arbitrary of all comprehensive tax systems”). Most advocates of estate tax repeal, however, show no interest in maintaining any significant degree of progressivity in the overall tax system.

⁶⁵ Any proposal to set the top marginal estate tax rate equal to the prevailing income tax rate for capital gains while retaining large exemptions would be equivalent for the vast majority of taxpayers to outright repeal of the estate tax. For the very rich, the effect would be equivalent to a deathtime gains tax with a reduced effective rate. By one estimate, the total revenue cost for fiscal years 2008-2012 of extending the estate tax cuts in the 2001 Act would be \$102.4 billion, while the cost of restoring the estate tax in 2010 with a \$5 million exemption (indexed for inflation) and a flat rate equal to the top capital gains rate would be \$74.8 billion, and the cost of restoring the estate tax with a \$3.5 million exemption (indexed for inflation) and a flat 45 percent rate would be \$30 billion. See CONG. BUDGET OFFICE, BUDGET OPTIONS 313-15 (2007).

⁶⁶ See GRAETZ & SHAPIRO, *supra* note 6, at 4 (“Estate tax repeal is one important strand of a looming effort to strip from our nation’s tax system the very idea that those who have more should shoulder a larger share of the tax burden.”); *id.* at 266-78 (linking estate tax repeal to broader antitax agenda).

downplays revenue costs, distributional effects, administrative concerns, and consequences for the rest of the tax system. The 2001 Act illustrates the gap between the abolitionists' simplistic anti-tax agenda and the complex reality of tradeoffs among competing tax and spending priorities. The estate tax cuts enacted in 2001 imply large revenue losses as well as a shift in tax burdens from the very rich to the middle class and from current taxpayers to future taxpayers. This appears to be a step in precisely the wrong direction, given growing inequalities of income and wealth and a looming fiscal gap.

As a practical matter, it seems increasingly unlikely that the estate tax will be permanently repealed. The protracted phase-out period and the sunset provision in the 2001 Act have exacerbated uncertainty and destabilized the tax system while encouraging strategic behavior by lawmakers and interest groups. In the ensuing game of brinkmanship, if the abolitionists fail to make repeal permanent, they will undoubtedly attempt to characterize the restoration of the estate tax as a tax increase. Nevertheless, if Congress is finally forced to confront the real implications of estate tax repeal and roll back some of the Bush administration's tax cuts, the abolitionists may find that their reach exceeds their grasp.

